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Economic Rescue Legislation: Questions and Answers

Q. How is the Bush financial crisis affecting average American families? And how does this bipartisan plan help?

A. The Bush financial crisis is hurting families all over the country. Working Americans are finding it more difficult to get loans to send kids to school, purchase a car, or buy a long-sought home, and the cost of borrowing is going up. Some American workers are losing their jobs, as businesses can't get the credit they need for day to day operations or to make payroll. And this crisis is raising concerns for the tens of millions of Americans who are saving for their own retirement, as the credit crunch causes sharp drops in stock values.

Failing to act to stem the Bush financial crisis would have put the nation at greater risk of a long and painful recession -- meaning more home foreclosures, lost jobs, declining house prices, and failing businesses.. As Fed Chairman Ben Bernanke stated, "I believe if the credit markets are not functioning that <u>jobs will be lost</u>, the <u>unemployment rate will rise</u>, <u>more houses will be foreclosed upon</u>, GDP will contract." Bernanke said that inaction would increase the number of jobs lost over the next four-to-six months by about 3.5 million, which would push the unemployment rate to the highest levels since the recession of the early 1980s -- or worse. "Main Street is as much at risk as Wall Street. If we failed to act, the resulting loss of jobs, malaise in growth, damage to the engines of our economy and harm to the American taxpayer would be far more costly," said Eugene A. Ludwig, a former U.S. comptroller of the currency (Los Angeles Times, 9/21/2008).

By buying up troubled assets from financial institutions, the bill will repair our institutions' damaged balance sheets, restore market confidence and unlock the flow of credit to American businesses and families. The Democratic Congress will ensure that taxpayers are protected in this package, and will continue to reform how business is done on Wall Street.

Q. How much will this legislation cost taxpayers?

A. The original Bush-Paulson plan has been dramatically improved with key protections requiring a plan that taxpayers be repaid in full and limits will be placed golden parachutes and excessive pay for Wall Street CEOs .

Specifically, the plan has been strengthened to give taxpayers an ownership stake in the participating companies to share in any gains and to protect against any losses from the sale of troubled assets.

After five years, if there are any costs to taxpayers despite these protections, the bill requires the President to present to Congress plan to recover any remaining shortfall from Wall Street and the banks, not taxpayers.

Taxpayer exposure is limited in other ways. After the first $250 billion is deployed to help our institutions, the President must certify the need for an additional $100 billion. After that, Congress can deny the President any additional funding. A strong Congressionally-appointed oversight board, GAO oversight and audits, a new independent Special Inspector General, meaningful judicial review, and online posting of transactions also provide the oversight and transparency that will help ensure taxpayer assets are protected.

Both the nonpartisan Congressional Budget Office and the Office of Management and Budget have said they expect the ultimate cost to be far less than $700 billion, and a growing number of independent analyses suggest taxpayers actually could profit from the legislation down the road. Barron's magazine, in this week's cover story, says "Barron's analysis of the plan indicates that taxpayers and their proxy, the Treasury Department, will fare well in the bailout and should actually turn a profit over the years ahead. For one thing, the mortgages and mortgage securities that the government will be buying back from commercial and investment banks, credit unions, insurance companies and others aren't as toxic or wide-spread as commonly assumed. Treasury's purchases should not only help free up credit markets but boost the prices of securities that are backed by home loans. That, in turn, is likely to arrest the relentless loop of falling home prices spawning further mortgage defaults and foreclosures that, in turn, result in further declines in residential real-estate prices." (Barron's, 9/29/08)

Q. Isn't this just a boon for Wall Street?

A. Congress acted to stabilize the American economy and help middle-income American families and small- and medium-sized businesses across America. This plan is desperately needed to preserve retirement savings, allow small businesses to increase jobs, and support small financial institutions that keep the economy humming on Main Street.

Congress insisted the measure include critical reforms, such as new restrictions on CEO and executive compensation for participating companies and requirements to help ensure the taxpayers are repaid in full, provisions preventing the unjust enrichment of banks, to make sure that middle-income American families are the primary beneficiary of this rescue, not Wall Street.

Congressional committees will continue the work of investigating and finding solutions to change the way business is done on Wall Street

Q. Is this government program to buy these financial institution assets permanent?

A. No. The Treasury Department's authority expires at the end of 2009.

Q. Why did Congress add "sweeteners" to the rescue that will cost taxpayers billions more?

To strengthen the economy, the measure includes over $100 billion in tax cuts and incentives that will create and save over 500,000 American green jobs, provide much-needed tax relief to middle-class families struggling to make ends meet in the face of the rising energy, health care, and grocery costs, and spur business investment and innovation.

House Democrats fought to make sure the tax cuts were paid for, but Senate Republicans continued the fiscal irresponsibility of the last eight years. And we made some progress.

All of the tax incentives to spur American energy independence are fully paid for – by closing a foreign tax loophole and stopping an increase in taxpayer subsidies for large oil companies. Further, nearly one-half of the other tax cuts for businesses and individuals are paid for by closing a loophole for corporate executives that ship investments offshore.

We are committed to pay-as-you-go budget discipline, and will continue to our efforts to reverse the out of control deficit spending that has plagued Washington under the Bush Administration and nearly doubled our national debt.

Q. Did the Community Reinvestment Act -- promoting lending in poor neighborhoods -- cause the subprime mortgage crisis that is the root of the more widespread financial crisis?

A. No. The Community Reinvestment Act does not apply to the institutions that made the vast majority of troubled loans underlying the crisis – it applies only to depository institutions, such as banks and savings and loans. Experts estimate that 80 percent of high-priced subprime loans were offered by financial institutions that are not subject to the CRA.

Former Fed governor Ned Gramlich praised CRA, saying last year that "banks have made many low- and moderate-income mortgages to fulfill their CRA obligations, they have found default rates pleasantly low, and they generally charge low mortgages rates. Thirty years later, CRA has become very good business." Studies by the Federal Reserve and Harvard's Joint Center for Housing Studies, among others, have shown that CRA increases lending and homeownership in poor communities without undermining banks' profitability.

Q. Isn't the failure to regulate Fannie Mae and Freddie Mac behind the crisis? Why didn't Democrats support these regulations?

A. In 6 years of complete control in Washington, Republicans failed to enact meaningful reform of Fannie Mae and Freddie Mac. In 2005, when former Financial Service Chairman Oxley pushed for responsible reform, he was opposed by Republican ideologues (Administration Senate Republicans). In fact he stated, "the critics have forgotten that the House passed a … reform bill in 2005 that could well have prevented the current crisis, says Mike Oxley, now vice-chairman of NASDAQ. All the handwringing and bedwetting is going on without remembering how the House stepped up on this," he says. "What did we get from the White House? We got a one-finger salute." [*Financial Times*, 9/9/08]

As soon as Democrats took over the House, we passed comprehensive GSE reform by a bipartisan vote of 313 to 104 in May 2007. When Democrats sought to include these critical reforms in the economic stimulus at the beginning of the year, the Bush Administration balked. Democrats enacted comprehensive reform in July 2008, after overcoming Republican filibusters in the Senate.

Q. Does the bill address the "mark to market" accounting rules that may have contributed to this crisis?

A. The bill reaffirms the SEC's authority to suspend the mark to market rules and requires a study.

Some financial institutions are holding assets on their books where the market has collapsed, such as the mortgage-backed securities based on sub-prime mortgages. Under mark-to-market rules, they are worth almost nothing, threatening those financial institutions who hold them with insolvency. If these financial institutions could place a value on the assets equal to the estimated value they should bring in the future, suddenly the balance sheets of these financial institutions would look a lot healthier.

Just this week the SEC announced that they will clarify these rules so that companies can use other ways to value these assets, which should lead to more appropriate valuations and more stability for these institutions.

Q. How did the Bush financial crisis happen?

A. Lack of regulatory oversight was the key factor behind the Bush financial crisis. "There was a lack of regulatory oversight during the Bush administration...that's one of the reasons we are in the mess that we are in... many bad mortgage loans and other loans were made in part because regulators were not empowered and were not playing their proper role." (Economist Mark Zandi, advisor to Sen. McCain, NPR, 9/16/08)

Throughout his two terms, President Bush and his Administration have refused to exercise their regulatory authority over the mortgage industry, put Republican ideologues in charge of vital agencies, ignored the housing bubble that led to irresponsible lending practices, obstructed Congressional legislation to reform the home lending industry as well as other reasonable regulatory reforms, and refused to monitor the activities surrounding complex and new financial instruments that ultimately led to this financial crisis.

In 2006, Moody's Economy.com warned that "problems in the mortgage-backed market would spill over into the rest of the U.S. fixed income and stock markets...The turmoil in the U.S. financial markets would immediately reverberate around the world, engendering a global financial event." (Moody's Economy.com, October 2006) Instead of heeding these critical warnings about the mortgage industry and working with Congressional Democrats to protect American consumers, regulators ignored these warnings, failed to enforce existing protections, and actually encouraged Americans to take out risky mortgages.

In 2004, then-Federal Reserve Chairman Alan Greenspan actually encouraged higher-risk mortgages. "When consumers hear from a Fed chairman that it makes little sense to take on fixed rate debt...not by coincidence, the adjustable rate portion of newly originated mortgage debt shot up...And should asset-dependent, saving-short, overly indebted American consumers feel at risk if the Fed assures them that there is no housing bubble?" (Morgan Stanley Chief Economist Stephen Roach, 4/22/05)

Further, fiscal irresponsibility of the Bush Administration – which has taken us from a $5.6 trillion surplus to a $3 trillion deficit -- has made this crisis all the worse. With that huge Bush deficit, we have grown increasingly dependent on foreign borrowing – with foreign borrowing more than doubling. With this financial crisis, foreign creditors have lost confidence in the U.S. economy and have been withdrawing their investment here in the U.S., squeezing the credit market even further.